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No. 03-272

In the Supreme Court of the United States

THE DOW CHEMICAL COMPANY, PETITIONER,

v.

THE AES CORPORATION, RESPONDENT.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

REPLY BRIEF FOR PETITIONER

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INTRODUCTION

In its attempt to minimize the conflict among the circuits, AES ignores a critical fact: the Third Circuit expressly acknowledged that its interpretation of Section 29(a) is contrary to the interpretation adopted by the Second Circuit. Indeed, the conflict is even deeper than the Third Circuit admitted, because the Seventh, First, and D.C. Circuits have all treated negotiated integration or non-reliance clauses as dispositive of the issue of reasonable reliance — a result that the Third Circuit expressly held was precluded by Section 29(a).

This conflict creates tremendous uncertainty in the world of corporate transactions. A corporation engaged in a major sale that includes a sale of stock cannot possibly monitor every piece of internal information a prospective buyer may obtain during due diligence in the same manner in which it monitors its financial statements and other public filings. If the Second Circuit's rule applies, the buyer and seller can solve this problem by making clear in writing which representations form the basis of the transaction — and which do not. If the Third Circuit's rule applies, however, then a corporate seller may have no choice but to cut back dramatically on the access it provides to prospective buyers. At present, there is no way to predict which rule will apply to a particular corporate transaction. This Court should intervene to settle the question.

DISCUSSION

1. *The Conflict with the Second Circuit.* AES argues that there are "significant factual differences" between *Harsco* and this case that make the apparent conflict between the Second and Third Circuits' decisions insignificant. Br. in Opp. 15. AES claims that, unlike the buyer in *Harsco*, it was "duped" into signing the non-reliance agreement by misrepresentations that Dow Chemical and Destec allegedly made during the course of due diligence. Based on this claimed factual distinction, AES contends that "there is no reason to

believe that the Second Circuit, if presented with this case, would reach the same result as it did in *Harsco*." *Id.* at 16.

There are a number of problems with AES's argument. First, the Third Circuit did not accept AES's invitation to distinguish *Harsco* on its facts. Instead, the Third Circuit rejected the Second Circuit's reasoning outright. The court quoted *Harsco's* conclusion that "a detailed writing developed via negotiations among sophisticated business entities and their advisors" simply "defines the boundaries of the transaction" and does not waive the purchaser's substantive rights under the Exchange Act. 91 F.3d at 343, quoted in Pet. App. 15a. It then characterized this reasoning as "unpersuasive," holding (contrary to the Second Circuit) that Section 29(a) "expressly forecloses contracting parties from 'defin[ing] the boundaries of the[ir] transaction' in a way that relieves a party of the duties imposed by that Act." *Id.* at 16a (quoting *Harsco*). The opinion below makes it crystal clear that its holding applies across-the-board to *any* non-reliance clause, regardless of the circumstances under which it was negotiated — a result that simply cannot be reconciled with the Second Circuit's reasoning in *Harsco*.

Second, AES's purported distinction between this case and *Harsco* dissolves on close examination. AES seizes upon the *Harsco* court's statement that there was nothing in the complaint or the agreements in that case "that indicates that Harsco was duped into waiving the protections of the securities laws." Br. in Opp. 16 (quoting 91 F.3d at 344). AES contends that, unlike the buyer in *Harsco*, it did allege that it was "duped" into entering into the non-reliance clauses because, when it attempted to determine the true facts behind the Elsta Project during due diligence, Dow Chemical and Destec supposedly responded by providing false information.

In so arguing, AES misreads *Harsco* and misstates the facts of this case. When it commented on whether the prospective buyer had been "duped," the *Harsco* court was refer-

ring to whether the non-reliance clause was the product of a disparity in *bargaining power*—not a disparity in information. 91 F.3d at 344. The discussion AES cites appears in *Harsco*'s treatment of *Rogen v. Ilikon Corp.*, where the First Circuit refused to enforce a contractual non-reliance provision in a sales agreement between an individual plaintiff and a corporate defendant. The Second Circuit noted that *Rogen* "emphasized the disparity in bargaining power between the plaintiff, an individual whom a jury could conclude was 'overtrusting,' and the defendant corporation." 91 F.3d at 344 (quoting *Rogen*, 361 F.2d at 267-268). The court concluded that there was no such disparity between the buyer and the sellers in *Harsco*, as they were all "sophisticated business entities negotiating at arm's length." *Id.* As evidence of the "relative parity" between the parties, the *Harsco* court cited the various protections that the buyer had been able to negotiate for itself in the transaction documents—including various due diligence provisions and substantive disclosures and representations. *Ibid.* The court concluded, as a matter of law, that under these circumstances there was no reason to believe that the buyer had been "duped" into agreeing to a non-reliance provision. *Ibid.*

In all relevant respects, the facts in this case are identical to those in *Harsco*. As in *Harsco*, it was undisputed here that there was no disparity in bargaining power between AES and the sellers. AES, like the buyer in *Harsco*, is a sophisticated corporate entity with a host of expert advisors, and it negotiated the transaction in this case at arm's length. Again like the buyer in *Harsco*, AES was in fact able to protect itself by securing a long list of representations and warranties in the final agreement covering a variety of critical issues, including capitalization, the absence of undisclosed liabilities, employee benefit plans, litigation, intellectual property matters, taxes, and environmental matters. *See* C.A. App. A201 (Table of Contents); Pet. 8. Furthermore, Destec represented and warranted the material accuracy and completeness of its peri-

odic SEC filings, including its annual reports, 10-Qs, and proxy statements. *See* C.A. App. A219, § 3.5.

AES complains (at 16) that its ability to protect itself through contractual warranties and representations was impaired because it supposedly had "no access to truthful and reliable information about the Elsta Project" and therefore "was not in a position to protect itself by negotiating detailed representations and warranties relating to the Project." It argues that *Harsco* was different because the Second Circuit emphasized that the buyer there had had an opportunity to conduct due diligence into the accuracy of the extra-contractual representations. *Id.* at 15. But that is not a correct reading of *Harsco*. In *Harsco*, the Second Circuit emphasized that the buyer was "apparently content" that the representations in the final agreement were "sufficiently complete" to protect its interests and had had the opportunity to test *those* representations through due diligence. 91 F.3d at 344. As the Second Circuit observed, when a buyer has agreed that it is relying only on certain representations that are admittedly true, it can hardly claim to have been "duped" into eschewing reliance on *other* representations. *Ibid.*

This case is indistinguishable from *Harsco.* As in *Harsco*, AES agreed that it would rely only on information that was embodied in a warranty and representation in the final agreement. And, as in *Harsco*, AES not only had plenty of opportunity to conduct due diligence concerning the accuracy of the representations made in the agreement, but also has never claimed that any of those representations were false. Under these circumstances, AES cannot claim to have been "duped" into agreeing to a non-reliance clause any more than the buyer in *Harsco* could. Nor can AES claim to have been any less able than the buyer in *Harsco* was to protect itself: if AES had wanted confirmation of the accuracy of the information provided to it about the Elsta plant, it could have and should have insisted on some type of warranty or representation concerning Elsta in the final agreement.

Indeed, on the facts this is an even clearer case than *Harsco* itself was for applying the Second Circuit's rationale. In *Harsco*, the buyer did not agree to a non-reliance clause until the final agreement was negotiated. In this case, by contrast, AES agreed from the outset, in the Confidentiality Agreement, that it would "not [be] entitled to rely on the accuracy or completeness of the Information" provided during due diligence unless that information was ultimately embodied in a warranty or representation. C.A. App. A197, ¶ 5. Having agreed to these ground rules *before* it received even a scrap of confidential information about Destec's assets, AES is hardly in a position to claim that it was "duped" into agreeing to a non-reliance clause.

As this discussion shows, the conflict between the Second and Third Circuits is both real and substantial. This Court should intervene to settle the issue and restore predictability to corporate transactions.

2. *The Decisions by the First, Seventh, and D.C. Circuits.* AES also contends that the decision below does not conflict with *Jackvony*, *Rissman*, or *One-O-One* because those decisions do not expressly discuss Section 29(a). But in these cases, the First, Seventh, and D.C. Circuits adopted a view of non-reliance clauses that effectively removes them from the purview of Section 29(a). As a result, these cases deepen the uncertainty surrounding the application of Section 29(a) in corporate transactions.

In each case, the court concluded that the non-reliance and integration clauses had the effect of disclaiming any representations that the parties did not agree to include in the transaction documents. *See One-O-One*, 848 F.2d at 1287 (R.B. Ginsburg, J.) (where there is a non-reliance clause, an agreement's silence on a particular subject is tantamount to an "abandonment or excision" of any prior representations the defendant may have made); *Jackvony*, 873 F.2d at 416 (Breyer, J.) (when the defendant made oral representations

about its future business plans but did not incorporate those representations into the final documents, the "entire agreement" clause rendered the previous representations unworthy of reasonable reliance); *Rissman*, 213 F.3d at 384 (Easterbrook, J.) (a non-reliance clause "has a similar function" to a corrective disclosure and "ensures that both the transaction and any subsequent litigation proceed on the basis of the parties' writings"); *see also id.* at 389 (Rovner, J., concurring) (a non-reliance clause is analogous to a "written disclaimer," which, if clear and understandable, will ordinarily preclude reasonable reliance).

So understood, a non-reliance clause is not an anticipatory waiver of future claims, as the Third Circuit concluded. *See* Pet. App. 10a. Rather, it is simply a statement that defines and limits the representations that the defendant is willing to make and willing to vouch for — as well as a statement of the material representations on which the plaintiff reasonably relied. Thus, while the courts in *Rissman*, *One-O-One* and *Jackovny* did not expressly discuss Section 29(a), their reasoning puts them squarely at odds with the decision below.

AES suggests that the First Circuit actually adopted the opposite view thirty years earlier in *Rogen v. Ilikon Corp.* But *Rogen* did not deal with a negotiated corporate transaction in which sophisticated parties agreed to rely only upon contractual representations. Instead, *Rogen* concerned whether an individual stockholder—who in the jury's eyes may have appeared inexperienced, "exceedingly gullible" and "overtrusting"—should be bound by contractual terms that purported to relieve the corporate defendant of *any* obligations to disclose material information. 361 F.2d at 267 (plaintiff represented "his non-reliance *on any duty to disclose* on the part of defendants") (emphasis added). The court commented that enforcing such a clause in those circumstances would undermine Section 29(a). *Id.* at 268.

Given those facts, it is not surprising that the First Circuit in *Jackvony* did not feel constrained by its earlier decision. *Jackvony* concerned a negotiated stock sale agreement between sophisticated corporate entities. Moreover, the non-reliance clause did not purport to relieve the corporate defendant of its "duty to disclose" material information. Rather, the clause in *Jackvony*, like the one at issue here, merely specified and limited the representations that the defendant was willing to vouch for. Accordingly, *Rogen* is entirely consistent with the First Circuit's subsequent decision in *Jackvony*.

AES's argument depends on the implausible assumption that the courts in *Rissman*, *One-O-One*, and *Jackvony* were all unaware of Section 29(a). Given the reasoning in those decisions, however, it is far more likely that they did not consider whether there had been an impermissible waiver under Section 29(a) because they had already concluded that their respective plaintiffs had no cause of action to waive. *See Harsco Corp. v. Bowden*, 1995 WL 152523, at *5 (S.D.N.Y. Apr. 5, 1995) ("The more plausible explanation for the lack of citation to this statute [in *One-O-One*] is the common understanding that it serves the narrow purpose of voiding contractual provisions that purport to deprive a party of legal recourse to the protections of the Exchange Act"), *aff'd*, 91 F.3d 337.

Indeed, the Seventh Circuit in *Rissman* must have been aware of Section 29(a), based upon the discussion of the statute in the decision it was reviewing. The district court in *Rissman* quoted Section 29(a) and explained that under the statute, "contract clauses may not include releases of claims under federal securities laws." *Rissman v. Rissman*, 1999 WL 495481, at *12 (N.D. Ill. June 30, 1999). The court then discussed at length the Seventh Circuit's decision in *Hamilton v. Harrington*, 807 F.2d 102 (7th Cir. 1986), which held that Section 29(a) is implicated only if the plaintiff can show an actionable misrepresentation for purposes of Rule 10b-5. The

district court in *Rissman* concluded that the non-reliance clause and other terms of the contract made it impossible for the plaintiff to establish that he had reasonably relied upon any misrepresentation outside the contract; the court held that, in view of the contract's clear terms, "all prior explicit representations. . .should vanish." 1999 WL 495481, at *7. Accordingly, in light of *Hamilton*, the court concluded that it "need not address the import of [Section] 29(a)." *Id.* at *13. Given the prominence of this discussion in the district court's opinion, AES cannot seriously suggest that Judge Easterbrook simply missed the issue.

3. *The Third Circuit's Misinterpretation of Shearson.* AES contends that under this Court's decision in *Shearson*, the relative sophistication of the parties and the voluntariness of any "waiver" should be totally irrelevant for purposes of Section 29(a). Accordingly, AES argues that *Shearson* would prohibit the creation of any special rule authorizing prospective waivers by sophisticated corporate parties. This argument mischaracterizes the real issue in this case.

Shearson held that "if a stipulation waives compliance with a statutory duty, it is void under § 29(a), whether voluntary or not." 482 U.S. at 230. But nothing in *Shearson* compels the conclusion that a court cannot take the parties' relative sophistication into account when determining whether there was a waiver in the first place.

In a typical corporate transaction involving sophisticated parties, the function of a non-reliance clause is to define and limit the representations that the parties agree were made and were reasonably relied upon by the opposing side. A sophisticated buyer would understand that it could not reasonably rely on any information obtained in due diligence relating to a particular subject matter unless that information was embodied in a representation or warranty in the agreement. Under the rule adopted by the Second Circuit, the non-reliance clause would conclusively establish that the buyer could not

reasonably rely on those representations and thus could not state a claim under Section 10(b). An unsophisticated individual, on the other hand, might not understand the impact of the non-reliance clause; in that case, as in *Rogen*, enforcing the clause against such an individual may well amount to a waiver of the protections of the Exchange Act.

The Third Circuit's decision does not allow for these subtleties. Instead, it interprets *Shearson* as compelling the conclusion that, regardless of the parties' sophistication, a non-reliance clause can never be dispositive on the issue of reasonable reliance. This Court should grant certiorari to correct the Third Circuit's misreading of *Shearson*.

4. *The Procedural Posture of this Case.* AES suggests that the Court should not use this case to consider the application of Section 29(a) because it has been remanded for (among other things) further factual inquiry into the reasonableness of AES's reliance. Br. in Opp. 17. But the remand will do nothing to illuminate the question presented by the Petition. The Third Circuit did not dispute that, absent Section 29(a), the non-reliance clause would have precluded a finding that AES reasonably relied on the representations it says were made about the Elsta plant, entitling Petitioner to summary judgment as a matter of law. As the Third Circuit also acknowledged, one of the purposes of a non-reliance clause is to avoid precisely the kind of "costly discovery" that Petitioner will be forced to endure in this case unless this Court grants the Petition and reverses the decision below. Pet. App. 14a.

Moreover, AES itself has taken the position that the remand is proceeding under the wrong legal standard. In its Cross-Petition (which Petitioner does not oppose), AES argues that the dissenting judge in the Third Circuit was right and that Section 29(a) should be read to void the non-reliance clause, precluding the finder of fact from giving it any weight at all in judging the reasonableness of AES's reliance. Thus,

no matter which side prevails on remand, the important issues presented by the Petition and the Cross-Petition regarding the impact of Section 29(a) on negotiated non-reliance clauses will still require this Court's review.

Predictability is essential in large corporate transactions. Parties to such transactions need to know, when due diligence is conducted and when warranties and representations are negotiated, whether customary non-reliance clauses are going to be enforced or not. The enforceability of such a clause should not depend on where the disappointed party chooses to file a lawsuit.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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